Service Date: February 18, 1982

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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In the Matter of Avoided Cost Based	)	
Rates for Public Utility Purchases	)	UTILITY DIVISION
from Qualifying Cogenerators and	)	DOCKET NO. 81.2.15
Small Power Producers.	)	ORDER NO. 4865a

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FINDINGS OF FACT

1. On February 24, 1968, the Commission initiated Docket No. 81.2.15 when it requested that the Montana-Dakota Utilities Company (MDU), the Montana Power Company (MPC), and the Pacific Power & Light Company (PP&L) file testimony proposing avoided cost methodologies and standard contracts for purchases of power from qualifying cogeneration and small production facilities (OF).

2. On January 4, 1982, the Commission issued Order No. 4865 setting forth the Commission's findings in this Docket.

3. On January 22, 1982, MDU, MPC, and PP&L each filed petitions for Reconsideration and/or Clarification. The petitions seek reconsideration and/or clarification of 20 identified items of issue in Order No. 4865.

4. Prior to providing its findings with respect to the specific requests for reconsideration the Commission wishes to reemphasize two policy findings that generally relate to most of the requested reconsiderations.

5. First, in several places (Finding Nos. 9, 13 and 38), the Order defines the Commission's intent with respect to the subject of this proceeding: the establishment of relatively simple standard rates available to all QF's, leaving businesslike negotiation of innovative contracts as the "prime mover in the purchase of QF's energy." Evident here is a desired level of flexibility by relying on the "good faith" principal. The utilities seem to have failed to fully appreciate this policy. By some of their motions, the utilities seem to seek a level of absolute certainty that is neither desirable nor even possible, given the many uncertainties inherent in this relatively new area of utility regulation.

6. The second policy statement thought to have been explicitly stated in the Order (Finding Nos. 12 and 37) pertains to moderation with subsequent refinement. This approach was made necessary by the general lack of knowledge concerning several critical issues. The utilities' response is again negative with their various claims that the order is not definite enough.

7. The Commission does not intend to deviate from the policy explicitly set forth in Order No. 4865, but merely wishes to remind the utilities that the flexibility and moderation resulting from the Order depends on the success of the businesslike negotiations and continual contributions to the refinement process.

I. The Role of Length of Contract

8. Order No. 4865 contemplates length of contract only in distinguishing availability to the long-term schedule versus the short-term schedule. Both PP&L and MDU request

reconsideration, arguing that long-term (e.g. 35 years) purchases are of greater value than short-term (e.g. 4 years).

9. The Commission rejects this motion. There is no language in the Order that precludes the utilities from paying more for 35 year contracts than for 4 year contracts.

II. The Role of Firm vs. Nonfirm

10. The Order does not provide an explicit firm/nonfirm distinction, with different rates reflecting a firm/nonfirm quality differential. PP&L and MDU argue that firm energy is of greater value than nonfirm energy and therefore, a rate differential should reflect the difference in quality.

11. The Commission rejects this motion. The utilities have not demonstrated that firm power is of greater value than the aggregation of nonfirm power. Furthermore, the four year performance commitment, with adjustment provisions, and the partial capacity payments provide sufficient quality differentials. Finally, there is no language in the Order that precludes the utilities from paying more for firm power should they perceive some quality differential beyond that provided in the tariffs.

III. The 8.3 Percent Line Loss Factor

12. The Order requires the inclusion of a "nominal" 8.3 percent line loss factor in the calculation of both the short term and long-term energy rates. MPC argues that 1) 8.3 percent is not nominal, 2) the record clearly indicates that the factor is not subject to calculation, and 3) in the formulae, "g" should possibly read "l+g."

13. The Commission rejects the motion. The inclusion of the 8.3 percent line loss factor is clearly an application of the Commission's moderation-with-subsequent-refinement principle. The record clearly indicates that avoided line losses will occur and that secondary marginal line losses for MPC approach 30 percent. The Commission finds inappropriate the proposal to assume a 0 percent line loss factor simply because the record did not provide a calculation. In regards to the formulae, the intent is a line loss factor of 1.083 applied to the energy calculation.

IV. Full Capacity Prepayment

14. The Order, at Finding No. 24, directs the establishment of capacity rates featuring full capacity prepayment partially based on the premise that the utilities incur planning costs prior to the on line date. MPC requests reconsideration arguing that their proposed calculation includes the planning costs.

15. The Commission is not contesting the inclusion or exclusion of the planning costs in the Company's calculations; at issue here is merely the timing of those costs. The motion is rejected.

V. Working Capital Costs

16. Finding No. 26 and Appendix B make reference to the inclusion of avoidable working capital costs in the energy calculations. MDU argues that the vague reference to working capital is "both inapplicable to avoided cost calculations and redundant" because these costs are included in energy and O&M.

17. As Finding No. 12 in Order No. 4865 explicitly states, the Commission is attempting to arrive at the full avoided costs -- nothing less and nothing greater. It follows that the Commission does not intend to include working capital twice. However, should MDU fail to provide a line item detailing avoided working capital, then the Commission will include an appropriate estimate.

VI. The Aggregate Capacity Credit

18. The Order directs the utilities to include, in the short-term energy calculation, an aggregate capacity credit. MPC asks "how QF output on an as available basis will allow deferral of capacity, and, further, how contracts of one year's duration will allow deferral of capacity." The Company further questions the evidentiary basis for establishing the aggregate credit at one-half of a full capacity payment.

19. The "aggregate" capacity credit was found appropriate on several grounds. The record provides a clear basis for the Commission to arrive at the decision that aggregated QF production has a capacity value. To avoid capacity, the utility must realize and incorporate into its system planning, a projected level of short-term QF activity. The short-term aggregate capacity credit avoids the administrative costs associated with metering, calculating, and paying a capacity payment to all short-term QF, yet it-recognizes the aggregate capacity value. Lastly, the basis for the 42.5 percent factor is an estimated 85 percent factor for a combustion turbine. This is one of those areas where lack of information requires an estimate, which will be refined with experience. The Commission finds as a matter of policy, in keeping with the statutory mandate requiring

encouragement of small power production, that it would be inequitable to ignore the aggregate capacity that will be contributed by small QF's.

VII. System Lambda

20. The Order repeatedly refers to "system lambda or equivalent short-term energy production modeling." MPC seeks clarification as to whether the Company's method of modeling a 10 MW block is acceptable.

21. The intent of the language in the Order was an acceptance of the short run energy modeling efforts of all three utilities. The Company, however, has raised a good point, which also relates to MDU's concern in paying a hypothetical 15 MW QF the standard short-term rate. Although the Commission rejects reconsideration, it leaves to future refinements the proper block of QF production to be modeled. One possibility is to use the previous year's aggregate QF production as a basis for calculating short-term avoided energy rates.

VIII. The Four Year Contract Duration Criterion

22. The Order establishes four years as the minimum contract duration required for availability to the long-term rate. PP&L argues that the four year level is arbitrary and "in no manner reflects each utility's specific cost avoidance."

23. The Commission rejects the motion. PP&L has not made clear why the four year level should reflect each utility's specific cost avoidance, only that it doesn't. The intent in establishing the four year test was to arrive at some length of QF performance commitment where the utilities may avoid

building baseload plants. One possibility is eight years, reflecting typical lead time. A second possibility is zero years, reflecting the aggregate-projection view. A third possibility is somewhere in between. The Commission found four years a moderate approach that allows for plant deferral possibilities as well as sales, at a minimum.

IX. The Partial Capacity Payment

24. The Order establishes a long-term capacity payment paid an 85 percent availability factor. PP&L requests reconsideration, arguing that the 85 percent "inherently discriminates against hydroelectric facilities which have a lower capacity factor."

25. The Commission rejects the motion for several reasons. The claim that 85 percent discriminates against hydro implies that some other, yet unknown, technology is given preferred treatment. The petition also does not make clear why hydro, versus wind, biomass, etc., should not be paid in proportion to performance. If hydro is performing at 40 percent annually, then why should it be paid as if operating at 85 percent? Alternatively, if hydro is operating at 85 percent for five months, why should it be paid full payment for the seven months it isn't operating?

X The Long-Term Energy Rate

26. MPC requests clarification as to whether the long-term energy rate represents 1) a flat rate over the length of the contract, 2) an annual update of a real dollar calculation, or 3) some other.

27. The long-term energy rate is an annual update of a real dollar calculation.

XI. Levelized Contracts

28. The Order does not address levelized contracts, other than to mention that 1) the Commission's rules (ARM 38.5.1901-1908) require the utilities to offer long-term levelized contracts and 2) that there are no provisions of the Order that restrict levelization. All three utilities submitted requests for clarification and more elaborate direction. MDU requested reconsideration regarding the combination of levelization with net billing or amortized interconnection -- the latter being a concern over the magnitude of ratepayer financing. Lastly, MPC requested an elaboration of the Order's reference to "appropriate rate making treatment" of losses.

29. The Commission's intent is clearly to leave leveliza tion to flexible business-like negotiations. However, for purposes of clarification, and to relieve MDU of the ratepayer financing syndrome, it should be pointed out that the Commission perceives levelization plans structured so that the present value of levelized payments exceeds the present value of tariffed QF rates over the life of the contract only to the degree that the utility realizes some net benefit in pursuing the longer term contract. That is, the Commission perceives some flexible financing charge which should resemble the utilities' incremental cost of capital. In such case the ratepayer and the utility should be indifferent to the amount of levelization. It is through negotiation that the utility and QF agree on length of contract, degree of levelization, and the effective financing rate. This finding also serves as a rejection of MDU's request barring levelization in combination with amortized interconnection.

30. MDU's request for reconsideration of levelization in combination with net billing is well taken. Should the QF select net billing, then he/she is necessarily precluded from levelization.

31. Finally, with respect to "appropriate ratemakig treatment of losses," the Commission simply means that reasonable losses will be treated as other reasonable expenses are treated.

XII. Net Billing

32. MPC requests clarification as to capacity payments under the net billing option. Under the long-term rate, net billing option, demand metered customers will be billed for their net energy consumption and, should they elect to install a second demand meter, their net demand consumption, as well. Nondemand metered customers will be billed for their net energy only because the nondemand metered energy rate reflects a capacity component.

XIII. Standard and Negotiated Rates and Contracts

33. MDU requests reconsideration/clarification with respect to 1) size limit on access to standard rate and contract and 2) the content of the standard contract versus the negotiated contract.

34. The standard rate and contract are to be included in the utilities' tariffs to be approved and regulated by the Commission and available to all QF's. The standard contract shall include all provisions addressed in Order No. 4865. A negotiated contract is a contract reflecting business-like

negotiation, which will be reflected in an addendum to the standard contract, if it is deemed necessary by one or both of the parties.

35. MDU's concern regarding size of QF, as discussed above in Finding No. 21, is well taken. There is no doubt that a 15 MW QF represents a significant block of capacity on the MDU system. However, the Commission rejects the motion and leaves to future refinement the treatment of large QF. One possibility is to approach the Commission with a proposed waiver and an alternate specific calculation to be used for purchases from a particular QF.

XIV. The June 1, 1982 Filing

36. The Order contemplates annual updates each June 1st, beginning in 1982. MPC requests reconsideration arguing that in light of the short period of time between the initial filing and the June update, "in the interest of efficiency and savings of time and expense, such a filing should be foregone."

37. The motion is granted. The Commission further finds that the proper approach entails an initial filing of costs and rates in constant contract year 1982 dollars, rather than in 1981 dollars per Order No. 4865. This provision makes unnecessary the June 1, 1982 filing.

XV. Further Study

38. The Order at Finding No. 38 directs the utilities to file evidence resulting from an investigation of transmission costs, and reserve requirement. MPC questions the desirability, over such a short time period, in applying

uncertain methodology, and requests reconsideration and/or methodological elaboration.

39. The motion is rejected; however, given that the June 1, 1982 update has been eliminated, the Commission finds merit in the Company's timing argument. The Commission finds that a filing of evidence with hearing concerning the requested evidence, proposed refinements, and revisions to the Commission's rules is necessary, and that such proceeding will be scheduled in the near future for the fall of 1982.

XVI. Negotiated Rates

40. PP&L requests clarification as to whether the Company can pay rates higher than the tariff rates and receive appropriate rate making treatment.

41. The Commission fully supports rates paid higher than the tariff, should the Company perceive some value beyond that reflected in the tariff. The resulting expenses will be given appropriate rate making treatment, including an examination of their reasonableness.

XVII. The Capacity Adjustment

42. Several motions were submitted seeking reconsideration/ clarification of the Order's capacity adjustment (i.e. penalty provision) in combination with liquidated damages and force majeure. These motions are treated below in the discussion of damages and force majeure. Specifically, in regard to the capacity adjustment, MPC requests clarification of the basis-contracted, expected, or actual deliveries of capacity--for calculating the adjustment.

43. The contracted capacity is to equal the expected capacity, and capacity factor during the first year of operation, The adjustments to pay and demonstrated capacity thereafter meets are to be based on actual deviation from the contracted capacity and capacity factor as directed in Order No. 4865.

XVIII. Liquidated Damages

44. Both MDU and PP&L have requested reconsideration of that part of the order requiring that all contracts contain liquidated damages clauses. In addition to a number of specific objections, both parties claim that common law damage remedies provide satisfactory protection both to the utilities and to the QF's. MDU points out that, since actual damages are readily ascertainable, liquidated damages clauses are unnecessary. The Commission finds these arguments persuasive, and, therefore, grants the reconsideration motions on this issue.

45. In granting these motions, the Commission relies substantially on the common law assumption that damages for breach of contract are designed to make the injured party whole, rather than to penalize the breaching party. Should the Commission detect in contract provisions, anything that smacks of penalties, this issue will be reexamined.

XIX. Force Majeure

46. MDU and PP&L have requested that the Commission reconsider its order relating to force majeure contract provisions.

47. MPC and PP&L both proposed force majeure clauses that excluded nonavailability of funds or lack of motive force to operate a QF's facility. However, PP&L excluded small hydro projects from its exclusion.

48. The Commission found in Order No. 4865 that small hydro projects should not be afforded special treatment and ordered that all utilities should include nonavailability of fuel in their force majeure clauses.

49. MDU argues that this provision would result in for giving the failure of any QF to perform, since "motive force" is at the heart of all small power production. PP&L argues that the order poses a serious problem with QF's relying on biomass, whose source of supply is subject to many factors not easily projected.

50. In view of these arguments, and upon further consideration of the issue, the Commission grants the motions for reconsideration. In doing so, the Commission finds that the standard force majeure clause, without any reference to motive force, should be incorporated in all contracts. So written, lack of motive force or availability of fuel will be treated the same as other incidents which may prevent full performance. That is, if they are unforeseeable and beyond the reasonable control of the party invoking the clause, performance will be excused; if they are not, remedies for breach will be available to the injured party.

51. Should PP&L and other utilities find that special provisions are required for QF's using biomass as a fuel source, they may make specific provisions for them in the contract.

XX. Complaint Procedures

52. PP&L asserts that the Commission's order makes complaint Procedures available to QF's but not to utilities. It therefore requests that the Commission makes its "good offices" available in reviewing disputes between utilities and QF's.

53. Based on PP&L's expressed concern, the Commission offers the following clarification on the issue. The Commission's Finding No. 75 contemplates good faith negotiation by the utility. As the stronger negotiating party, the Commission expects that utilities can, and will, protect their interests. If in doing so, the utility requires terms considered onerous by the QF, or refuses to contract with the QF, the natural course of events would be a complaint to the Commission from the QF.

54. By its finding No. 75, the Commission merely meant to make clear to utilities that, within the parameters set out by rules and orders of the Commission, they should negotiate freely without seeking Commission involvement. Complaint procedures contemplate actions from one aggrieved. In the context of interconnection of QF's, it is difficult to contemplate a time when a utility would be aggrieved in the negotiating process.

55. Should a utility encounter a situation where it is uncertain of the Commission's policy or rules, it may petition for a declaratory ruling under the Montana Administrative Procedure Act, 2-4-501, MCA. As a practical matter, the Commission contemplates that many of the initial uncertainties can be resolved by communications among the affected QF, the affected utility and the Commission staff,

with the staff advising the Commission of issues that require formal determination. This informal procedure is available to utilities as well as to QF's.

CONCLUSIONS OF LAW

1. Montana-Dakota Utilities Company, Montana Power Company and Pacific Light & Power Company are public utilities within the meaning of Montana law, Sections 69-3-101 and 69-3-601(3), MCA.

2. The Commission properly exercises jurisdiction over the rates and terms and conditions for the purchase of electricity, by public utilities from qualified cogenerators and small power producers. Sections 69-3-102, 69-3-103 and 69-3-603, MCA. Section 210, Pub. L. 95-617, 92 Stat. 3119 (1978).

3. The rates the Commission has directed the utilities to file are just and reasonable to Montana ratepayers as they reflect each utility's avoided energy and capacity costs.

4. The objective of encouraging cogeneration and small power production is promoted by the rates and terms and conditions established by this order.

5. In a recent decision, the District of Columbia Circuit Court of Appeals found portions of the FERC's cogeneration/small power production rules to be invalid. American Electric Power Service Corporation v. Federal Energy Regulatory Commission, No. 80-1789 (Jan. 22, 1982). Although the final outcome of that litigation has not been determined, it is the Commission's belief that the substance of Order No. 4865 is not threatened by the decision. The Commission's

order is based upon 69-3-601, et seq., MCA, Montana's "mini-PURPA." The statute specifically states that rates for qualifying facilities should be set at the avoided cost, the cost of production plus a reasonable return or "any other method that will promote the development of qualifying small power production facilities." 69-3-604, MCA This statute is substantially different from the federal statute, upon which the D C. Circuit based its decision regarding FERC's use of avoided cost and requirements for interconnection of QF's. In balancing ratepayer and QF interests, the Commission relied both on its obligations under the general Provisions of Title 69, MCA, and the specific provisions of 69-3-601, et seq., MCA. Reading relevant provisions together, the Commission found avoided costs basis for prices to be paid QF's. The D.C. to be the proper Circuit's decision does not change that opinion.

6. As for interconnection requirements, Montana law, 69-3-603, MCA, places a statutory obligation upon the Commission: .[T]he Commission shall require the utility to purchase the and conditions established under the electricity under rates provisions of subsection (2)." The Commission interprets this provision as requiring interconnection under approved terms. Unlike the federal law, there are no other requirements to be met before there is interconnection. Thus, the D.C. Circuit's decision that FERC did not adequately consider statutorily enumerated l criteria is not relevant to the Commission's requirement for interconnection.

ORDER

The motions for reconsideration and clarification are granted and denied as noted in the Findings of Fact contained in this order.

Done and Dated this 16th day of February by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

GORDON E. BOLLINGER, Chairman

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

THOMAS J. SCHNEIDER, Commissioner

ATTEST:

Madeline L. Cottrill
Commission Secretary

Commissioner

(SEAL)

NOTE: You may be entitled to judicial review of the final decision in this matter. If no Motion for Reconsideration is filed, judicial review may be obtained by filing a petition for review within thirty (30) days from the service of this order. If a Motion for Re consideration is filed, a Commission order is final for purpose of appeal upon the entry of a ruling on that motion, or upon the passage of ten (10) days following the filing of that motion. cf. the Montana Administrative Procedure Act, esp. Sec. 2-4-702, MCA; and Commission Rules of Practice and Procedure, esp. 38.2.4806 ARM.